Appendices I and II

Appendix I

CONSTITUTIONAL AND STATUTORY PROVISIONS OF THE STATE OF CALIFORNIA CONCERNING THE GROSS RECEIPTS TAX.

Constitution Section 14, Article XIII.

Sec. 14. Taxes levied, assessed and collected as hereinafter provided upon railroads, including street railways, whether operated in one or more counties; sleeping car, dining car, drawingroom car and palace car companies, refrigerator, oil, stock, fruit, and other car-loaning and other car companies operating upon railroads in this State; companies doing express business on any railroad, steamboat, vessel or stage line in this State; telegraph companies; telephone companies; companies engaged in the transmission or sale of gas or electricity; insurance companies; banks, banking associations, savings and loan societies, and trust companies; and taxes upon all franchises of every kind and nature, shall be entirely and exclusively for State purposes, and shall be levied, assessed and collected in the manner hereinafter provided. The word "companies" as used in this section shall include persons, partnerships, joint stock associations, companies, and corporations.

(*a*) All railroad companies, including street railways, whether operated in one or more counties; all sleeping car, dining car, drawingroom car, and palace car companies, all refrigerator, oil, stock, fruit and other car-loaning and other car companies, operating upon the railroads in this State; all companies doing express business on any railroad, steamboat, vessel or stage line in this

State; all telegraph and telephone companies; and all companies engaged in the transmission or sale of gas or electricity shall annually pay to the State a tax upon their franchises, roadways, roadbeds, rails, rolling stock, poles, wires, pipes, canals, conduits, rights of way, and other property, or any part thereof used exclusively in the operation of their business in this State, computed as follows: Said tax shall be equal to the percentages hereinafter fixed upon the gross receipts from operation of such companies, and each thereof within this State. When such companies are operating partly within and partly without this State, the gross receipts within this State shall be deemed to be all receipts on business beginning and ending within this State, and a proportion, based upon the proportion of the mileage within this State to the entire mileage over which such business is done, of receipts on all business passing through, into or out of this State.

The percentages above mentioned shall be as follows: On all railroad companies, including street railways, four per cent; on all sleeping car, dining car, drawingroom car, palace car companies, refrigerator, oil, stock, fruit, and other car-loaning and other car companies, three per cent; on all companies doing express business on any railroad, steamboat, vessel or stage line, two per cent; on all telegraph and telephone companies, three and one-half per cent; on all companies engaged in the transmission or sale of gas or electricity, four per cent. Such taxes shall be in lieu of all other taxes and licenses, State, county and municipal, upon the property above enumerated of such companies except as otherwise in this section provided; *provided*, that nothing herein shall be construed to

release any such company from the payment of any amount agreed to be paid or required by law to be paid for any special privilege or franchise granted by any of the municipal authorities of this State.

(*b*) Every insurance company or association doing business in this State shall annually pay to the State a tax of one and one-half per cent upon the amount of the gross premiums received upon its business done in this State, less return premiums and reinsurance in companies or associations authorized to do business in this State; *provided*, that there shall be deducted from said one and one-half per cent upon the gross premiums the amount of any county and municipal taxes paid by such companies on real estate owned by them in this State. This tax shall be in lieu of all other taxes and licenses, State, county and municipal, upon the property of such companies, except county and municipal taxes on real estate, and except as otherwise in this section provided; *provided*, that when by the laws of any other state or country, any taxes, fines, penalties, licenses, fees, deposits of money, or of securities, or other obligations or prohibitions, are imposed on insurance companies of this State, doing business in such other state or country, or upon their agents therein, in excess of such taxes, fines, penalties, licenses, fees, deposits of money, or of securities, or other obligations or prohibitions, imposed upon insurance companies of such other state or country, so long as such laws continue in force, the same obligations and prohibitions of whatsoever kind may be imposed by the Legislature upon insurance companies of such other state or country doing business in this State.

(c) The shares of capital stock of all banks, organized under the laws of this State, or of the United States, or of any other state and located in this State, shall be assessed and taxed to the owners or holders thereof by the State Board of Equalization, in the manner to be prescribed by law, in the city or town where the bank is located and not elsewhere. There shall be levied and assessed upon such shares of capital stock an annual tax, payable to the State, of one per centum upon the value thereof. The value of each share of stock in each bank, except such as are in liquidation, shall be taken to be the amount paid in thereon, together with its pro rata of the accumulated surplus and undivided profits. The value of each share of stock in each bank which is in liquidation shall be taken to be its pro rata of the actual assets of such bank. This tax shall be in lieu of all other taxes and licenses, State, county and municipal, upon such shares of stock and upon the property of such banks, except county and municipal taxes on real estate and except as otherwise in this section provided. In determining the value of the capital stock of any bank there shall be deducted from the value, as defined above, the value, as assessed for county taxes, of any real estate, other than mortgage interests therein, owned by such bank and taxed for county purposes. The bank shall be liable to the State for this tax and the same shall be paid to the State by them on behalf of the stockholders in the manner and at the time prescribed by law, and they shall have a lien upon the shares of stock and upon any dividends declared thereon to secure the amount so paid.

The moneyed capital, reserve, surplus, undivided profits and all other property belonging to unincorporated banks or bankers of this State, or held by any bank located in this State which has no shares of capital stock, or employed in this State by any branches, agencies, or other representatives of any banks doing business outside of the State of California, shall be likewise assessed and taxed to such banks or bankers by the said Board of Equalization, in the manner to be provided by law and taxed at the same rate that is levied upon the shares of capital stock of incorporated banks, as provided in the first paragraph of this subdivision. The value of said property shall be determined by taking the entire property invested in such business, together with all the reserve, surplus, and undivided profits, at their full cash value, and deducting therefrom the value as assessed for county taxes of any real estate, other than mortgage interests therein owned by such bank and taxed for county purposes. Such taxes shall be in lieu of all other taxes and licenses, state, county and municipal, upon the property of the banks and bankers, mentioned in this paragraph, except county and municipal taxes on real estate and except as otherwise in this section provided. It is the intention of this paragraph that all moneyed capital and property of the banks and bankers mentioned in this paragraph shall be assessed and taxed at the same rate as an incorporated bank, provided for in the first paragraph of this subdivision. In determining the value of the moneyed capital and property of the banks and bankers mentioned in this subdivision, the said State Board of Equalization shall include and assess to such banks all property and everything of value owned or held by them, which go to make

up the value of the capital stock of such banks and bankers, if the same were incorporated and had shares of capital stock.

The word "banks" as used in this subdivision shall include banking association, savings and loan societies and trust companies, but shall not include building and loan associations.

(*d*) All franchises, other than those expressly provided for in this section, shall be assessed at their actual cash value, in the manner to be provided by law, and shall be taxed at the rate of one per centum each year, and the taxes collected thereon shall be exclusively for the benefit of the State.

(*e*) Out of the revenues from the taxes provided for in this section together with all other State revenues, there shall be first set apart the moneys to be applied by the State to the support of the public school system and the State University. In the event that the above named revenues are at any time deemed insufficient to meet the annual expenditures of the State, including the above named expenditures for educational purposes, there may be levied, in the manner to be provided by law, a tax for State purposes, on all the property in the State including the classes of property enumerated in this section, sufficient to meet the deficiency. All property enumerated in subdivisions *a*, *b*, and *d* of this section shall be subject to taxation in the manner provided by law, to pay the principal and interest of any bonded indebtedness created and outstanding by any city, city and county, county, town, township or district, before the adoption of this section. The taxes so paid for prin-

cipal and interest on such bonded indebtedness shall be deducted from the total amount paid in taxes for State purposes.

(*f*) All the provisions of this section shall be self-executing, and the Legislature shall pass all laws necessary to carry this section into effect, and shall provide for a valuation and assessment of the property enumerated in this section, and shall prescribe the duties of the State Board of Equalization and any other officers in connection with the administration thereof. The rates of taxation fixed in this section shall remain in force until changed by the Legislature, two-thirds of all the members elected to each of the two houses voting in favor thereof. The taxes herein provided for shall become a lien on the first Monday in March of each year after the adoption of this section and shall become due and payable on the first Monday in July thereafter. The gross receipts and gross premiums herein mentioned shall be computed for the year ending the thirty-first day of December prior to the levy of such taxes and the value of any property mentioned herein shall be fixed as of the first Monday in March. Nothing herein contained shall affect any tax levied or assessed prior to the adoption of this section; and all laws in relation to such taxes in force at the time of the adoption of this section shall remain in force until changed by the Legislature. Until the year 1918 the State shall reimburse any and all counties which sustain loss of revenue by the withdrawal of railroad property from county taxation for the net loss in county revenue occasioned by the withdrawal of railroad property from county taxation. The Legislature shall provide for reim-

bursement from the general funds of any county to districts therein where loss is occasioned in such districts by the withdrawal from local taxation of property taxed for state purposes only.

(*g*) No injunction shall ever issue in any suit, action or proceeding in any court against this State or against any officer thereof to prevent or enjoin the collection of any tax levied under the provisions of this section; but after payment action may be maintained to recover any tax illegally collected in such manner and at such time as may now or hereafter be provided by law. [*New section adopted November 8, 1910.*]

Political Code Sections 3664, 3664a, 3664d, 3664e, 3665a, 3665b, 3665c, 3666, 3668a and 3668c.

SEC. 3664. TAXES FOR STATE PURPOSES. Taxes levied, assessed and collected as hereinafter provided upon railroads, including street railways, whether operated in one or more counties; sleeping-car, dining-car, drawing-room car and palace-car companies, refrigerator, oil, stock, fruit, and other car-loaning and other car companies operating upon railroads in this state; companies doing express business on any railroad, steamboat, vessel or stage line in this state; telegraph companies; telephone companies; companies engaged in the transmission or sale of gas or electricity; insurance companies; banks, banking associations, savings and loan societies, and trust companies; and taxes upon all franchises of every kind and nature, shall be entirely and exclusively for state purposes, and shall be assessed and levied by the state board of equalization, and collected in the manner hereinafter provided. The word "company" and the word "com-

panies" as used in section fourteen of article thirteen of the constitution of this state and in the sections of this code enacted to carry the same into effect shall include persons, partnerships, joint stock associations, companies, and corporations.

Sec. 3664a. Public Utilities to Pay State Tax. 1. All railroad companies, including street railways, whether operated in one or more counties; all sleeping-car, dining-car, drawing-room car and palace-car companies, all refrigerator, oil, stock, fruit, and other car-loaning, and other car companies, operating upon the railroads in this state; all companies doing express business on any railroad, steamboat, vessel, or stage line in this state; all telegraph and telephone companies; and all companies engaged in the transmission or sale of gas or electricity shall annually pay to the state a tax upon their franchises, roadways, roadbeds, rails, rolling stock, poles, wires, pipes, canals, conduits, rights of way, and other property, or any part thereof, used exclusively in the operation of their business in this state, computed as follows: Said tax shall be equal to the percentages hereinafter fixed upon the gross receipts from operation of such companies and each thereof within this state.

2. Companies Partly Within and Without State. When such companies are operating partly within and partly without this state, the gross receipts within this state shall be deemed to be all receipts on business beginning and ending within this state, and a proportion, based upon the proportion of the mileage within this state to the entire mileage over which such business is done, of receipts on all business passing through, into, or out of this state.

3. Percentages. The percentages above mentioned shall be as follows: On all railroad companies, seven per cent; on all street railways, herein defined to include interurban electric railways and gasoline propelled railways, five and a quarter per cent; on all sleeping-car, dining-car, drawing-room car, palace-car companies, refrigerator, oil, stock, fruit, and other car-loaning, and other car companies, five and one-quarter per cent; on all companies doing express business on any railroad, steamboat, vessel or stage line, one per cent; on all telegraph and telephone companies five and one-half per cent; on all companies engaged in the transmission or sale of gas or electricity, seven and one-half per cent.

4. In Lieu of Other Taxes. Such taxes shall be in lieu of all other taxes and licenses, state, county, and municipal, upon the property above enumerated of such companies except as otherwise provided in section fourteen of article thirteen of the constitution of this state.

5. "Municipal" Defined. Percentage for Street Railways. The word "municipal" as used in section fourteen of article thirteen of the constitution of this state and in the sections of this code enacted to carry the same into effect shall apply to incorporated towns and cities formed under article eleven of the constitution of this state and to none other.

In the event that it shall be hereafter finally determined by the courts that the legislature is without power to fix a different percentage upon the gross receipts from operation of street railways than the percentage herein fixed for railroad companies, then the percentage upon the gross receipts from operation of street railways is hereby fixed at seven per cent.

Sec. 3664d. Assessment and Tax of Franchises. All franchises, other than those of the companies mentioned in sections three thousand six hundred sixty-four *a*, three thousand six hundred sixty-four *b*, and three thousand six hundred sixty-four *c* of this code, shall be assessed at their actual cash value, after making due deduction for goodwill, in the manner hereinafter provided, and shall be taxed at the rate of one and six-tenths per centum each year, and the taxes collected thereon shall be exclusively for the benefit of the state. These franchises shall include the actual exercise of the right to be a corporation and to do business as a corporation under the laws of this state and the actual exercise of the right to do business as a corporation in this state when such right is exercised by a corporation incorporated under the laws of any other state or country, also the right, authority, privilege, or permission to maintain wharves, ferries, toll roads, and toll bridges, and to construct, maintain or operate, in, under, above, upon, through or along any streets, highways, public places, or waters, any mains, pipes, canals, ditches, tanks, conduits or other means for conducting water, oil, or other substances.

Sec. 3664e. Investigations, Appraisements, and Valuations. The state board of equalization shall make, or cause to be made, such investigations, appraisements and valuations and collect such other data as it deems proper for the purpose of enabling it to report to each legislature at the convening thereof, the relative percentages of tax borne by corporations and industries paying taxes to the state under part III, title IX, of this code as compared to the percentage or rate of ad valorem tax

borne by property taxed for local, county, city and county, city or district purposes, and shall include its findings thereon in its biennial report to the governor, as required under section 3692 of this code.

Sec. 3665a. "Gross Receipts From Operation" Defined. Hearing on Claim of Double Taxation. 1. The term "gross receipts from operation" as used in section three thousand six hundred sixty-four *a* of this code is hereby defined to include all sums received from business done within this state, during the year ending the thirty-first day of December last preceding, including the company's proportion of gross receipts from any and all sources on account of business done by it within this state, in connection with other companies described in said section.

Any company claiming that the levy of the percentage fixed by section three thousand six hundred sixty-four *a* of this code on the total gross receipts of such company results in double taxation of the property of such company, may make application to the state board of equalization for a hearing on such matter. Said board shall have power to take evidence and determine the facts with respect to such claim and in event said board finds the claim of such company to be true, said board may authorize such company to deduct from its reported gross receipts that amount of such receipts which, if included in such total gross receipts, would cause such double taxation.

2. Companies Partly Within and Without State. In case of companies operating partly within and partly without this state, the gross receipts within this state shall be deemed to be all receipts on business beginning and end-

ing within this state, and the proportion based upon the proportion of the mileage within this state to the entire mileage over which such business is done, of receipts on all business passing through, into or out of this state.

3. No Deductions Allowed. No deduction shall be allowed from the gross receipts from operation for commissions, rebates, or other repayments, except only such refunds as arise from errors or overcharges; nor shall any deduction be allowed for payments from gross receipts to other companies for any purpose whatsoever, except such refunds as arise from errors or overcharges.

4. Income From Nonoperative Property Not Included. Income derived from property not defined in this section and in sections three thousand six hundred sixty-four *a*, three thousand six hundred sixty-five *b* and three thousand six hundred sixty-five *c* of this code as operative property shall not be included in the gross receipts for the purpose of determining the tax on the property and franchises provided for in section three thousand six hundred sixty-four *a* of this code.

Sec. 3665b. "Operative Property". The term "operative property" as used in any section of this code shall include:

(a) Railroad Companies. In the case of railroad companies, including street railways: The franchises, roadway, roadbed, rails, rolling stock, rights of way, sidings, spur-tracks, switches, signal systems, cranes and structures used in loading and unloading cars, fences along the right of way, poles, wires, conduits, power lines, piers, used exclusively in the operation of the railroad business, depot grounds and buildings, ferry-boats, tugs and car-floats

used exclusively in the operation of the railroad business; machine-shops, repair-shops, roundhouses, car barns, power-houses, substations, and other buildings, used in the operation of the railroad business and so much of the land on which said shops, houses, barns, and other buildings are situate as may be required for the convenient use and occupation of said buildings.

(b) Car Companies. In the case of sleeping car, dining car, drawing-room car and palace-car companies, refrigerator, oil, stock, fruit and other car-loaning, and other car companies operating upon railroads in this state: The franchises, cars, and other rolling stock.

(c) Express Companies. In the case of companies doing express business on any railroad, steamboat, vessel or stage line in this state: The franchises, cars, trucks, wagons, horses, harness, and safes.

(d) Telegraph and Telephone Companies. In the case of telegraph and telephone companies doing business in this state: The franchises, rights of way, poles, wires, pipes, conduits, cables, switchboards, telegraph and telephone instruments, batteries, generators, and other electrical appliances, and exchange and other buildings used in the telegraph and telephone business and so much of the land on which said buildings are situate as may be required for the convenient use and occupation of said buildings.

(e) Gas and Electric Companies. In the case of companies engaged in the transmission or sale of gas or electricity: The franchises, towers, poles, wires, pipes, canals, tunnels, ditches, flumes, aqueducts, conduits, rights of way, dams, reservoirs, water and water rights used exclusively

in the business of the transmission or sale of gas or electricity; transformers, substations, gas-holders, gas and electric generators, switches, switchboards, meters, electrical and gas appliances, oil-tanks, power plants, powerhouses, and other buildings and structures used in the operation of the business of the transmission or sale of gas or electricity and so much of the land on which said buildings and structures are situate as may be required for the convenient use and operation of said buildings; provided, that the operative property of the companies enumerated in this section, shall also include any other property not above enumerated that may be reasonably necessary for use by said companies exclusively in the operation and conduct of the particular kinds of business enumerated in section three thousand six hundred sixty-four *a* of this code. The operative property mentioned in subdivisions (a), (b), (c), (d), and (e), of this section shall not be subject to taxation for county, municipal, or district purposes except as otherwise provided for in the constitution and laws of this state; provided, however, that when any piece or parcel of property in this state owned by any of the companies mentioned in section three thousand six hundred sixty-four *a* of this code is used partially by such company for any use reasonably necessary to the operation of any of the lines of business enumerated in said section and such property is also partially rented to or used by others or is partially used by the company for some other lines of business not among those so enumerated, or for purposes not reasonably necessary to the operation of any of said enumerated lines of business, it shall be considered operative property in that proportion only which that part of the property

mentioned in the proviso used by the company in the operation of any of said enumerated lines of business bears to the whole of the property mentioned in this proviso.

2. Construction Property Nonoperative. Any property of the classes mentioned in this section owned by a company constructing a new railroad, street railway, telegraph or telephone system, or plant or system for the transmission or sale of gas or electricity, no part of which new road, line, plant or system is in operation, and the same classes of property when held by an operating company solely for the construction of a new railroad or railway line, a new telegraph or telephone system, or a new plant or system for the transmission or sale of gas or electricity, and not to be used for betterments or additions to roads, lines, plants, or systems already under operation, shall not be considered operative property and shall be subject to assessment and taxation for county, municipal, and district purposes. Any part of such property of any company mentioned in this section shall be classed and assessed as operative property when the state board of equalization shall determine that such property is rendering a substantial public service.

3. Rules of State Board of Equalization. The state board of equalization shall have power to make rules and issue instructions not inconsistent with the constitution and laws of this state for the guidance of assessors in determining what is operative property and what is nonoperative property of companies named in this section.

Sec. 3665c. Annual Report by Companies. Such person or officer, as the state board of equalization may designate, of each of the companies mentioned in section three

thousand six hundred sixty-four *a* of this code, shall within ten days after the first Monday in March of each year, file with the said board a report signed and sworn to by one or more of said persons or officers, showing in detail for the year ending the thirty-first day of December last preceding, the various items as follows:

1. NAME, ETC. The name of the company, its nature, whether a person or persons, a partnership (with names of partners), an association, or corporation, and under the laws of what state, territory or country organized, the nature of its business, the location of its principal place of business, the names and post office addresses of its president, secretary, auditor, treasurer, superintendent, and general manager, the location of its principal place of business in this state, the name and post office address of its chief officer or managing agent in this state, and the names and addresses of all subsidiary companies whose property and business are operated by it and the names and addresses of any company of which it may be subsidiary.

2. OPERATIVE PROPERTY. Each of the companies mentioned in said section shall report, in such detail as the state board of equalization shall prescribe, all of its property in this state which comes under the definition of operative property in section three thousand six hundred sixty-five *b* of this code. When any such company operates both within and without this state it shall report the mileage over which it operates both within and without this state. It shall also report the location of said property within this state by counties, cities and counties, municipalities, and districts, in such manner and in such detail

as said board of equalization shall prescribe. It shall also, at the same time, furnish a duplicate of the report covering so much of said property as is located in any county, city and county, municipality, or district, to the assessor of the county, city and county, city or district in which such property is located. The state board of equalization may require the filing in its office of maps descriptive of all the operative property of any such companies, and may prescribe the form and size of such maps and the details to be shown therein, and may require that similar maps descriptive of the operative property within each county, city and county, municipality, or district, shall be filed in the assessor's office in each county, city and county, city or district in which any of said property is located.

3. Capital Stock. The amount of capital stock issued, and the amount of money received therefor, showing separately the capital stock issued, and the money received therefor of the operating company and of each subsidiary company in this state.

4. Dividends. The dividends paid during the year ending the thirty-first day of December last preceding, the surplus fund, if any, on said thirty-first day of December, or between such periods as the state board of equalization may determine, those of the operating company and of each subsidiary company in this state to be shown separately.

5. Debts. The funded and floating debts and the rate of interest thereon, showing separately the debts of the operating company and of each subsidiary company in

this state, on the thirty-first day of December last preceding.

6. Value of Stock. The market value of the stock and of the outstanding bonds, or, when said stock or bonds have no market value, the actual value thereof, for such periods and for such dates as the state board of equalization shall prescribe.

7. Improvements. The amounts expended for improvements during the year ending the thirty-first day of December last preceding, how expended and the character of the improvements.

8. Gross Receipts. The gross receipts from operation within this state for the year ending the thirty-first day of December last preceding, the gross receipts from such classes of business as the state board of equalization may designate, to be reported separately; also where the property and business are partly within and partly without this state, the gross receipts for said period on all business beginning and ending entirely within this state, and that proportion of the gross receipts from all business passing through, into, or out of this state, which the mileage within this state bears to the total mileage over which such interstate business is done as further defined in section three thousand six hundred sixty-five *a* of this code.

9. Expenses. The operating and other expenses.

10. Profit and Loss. The balance of profit and loss, between such periods as the state board of equalization may determine.

11. Other Matters. Subsidiary Companies. Defined. Such other matters as the state board of equalization may

deem necessary in order to enable it to assess and levy the taxes provided for in section fourteen of article thirteen of the constitution of this state.

Each such company shall include in its report the property and business of all subsidiary companies as that term is hereinafter defined in this section, whose property and business are operated by it, whether by virtue of a lease, an operating contract or agreement, or by virtue of control, through the ownership of stock or otherwise, even though such subsidiary companies maintain an independent legal existence and separate accounts.

The term "subsidiary company" is hereby defined as applying to a company which is merged in the operating system of an operating company in any of the ways above stated, whose property and franchises would be taxable under section three thousand six hundred sixty-four *a* of this code if the same were operated independently. No separate report need be rendered by a subsidiary company whose property, franchises, and operations are fully and completely covered by the report of an operating company, unless the state board of equalization shall deem such a separate report necessary.

Each such company operating the property or business of a subsidiary company in some line of business to which a different percentage of the gross receipts is applied by said section from that applied by said section to the gross receipts of the operating company, shall report such receipts of the subsidiary company separately.

Sec. 3666. Notice by Assessor of Property Regarded Nonoperative. Hearing. 1. If any assessor finds in the

report of the operative property in his county, city and county, municipality, or district, furnished to him by any of the companies as required in section three thousand six hundred sixty-five *c* of this code, any piece or parcel of property which he regards as nonoperative property, or partially operative and partially nonoperative, he shall, within thirty days after receiving such report, notify the state board of equalization thereof by mail, which notice shall contain a general description of the property and the assessor's reasons for regarding the same as nonoperative property. He shall also mail a copy of the notice to the company whose property is involved. The said board shall investigate the nature of the property and its use, and if an agreement between the said board, the assessor, and the company as to the proper classification of such property cannot be reached, then the said board shall, under such rules of notice as it may deem reasonable, set a date for a hearing, at which the assessor and the company may be present or represented. At such hearing the board shall, from the evidence presented and from the best information it can obtain decide the matter in dispute, and determine whether such property is operative or nonoperative or in what proportion operative and in what proportion nonoperative. The said board shall enter its decision in its minutes, and shall send a copy thereof to the county assessor and the company, and also to the proper officer of any municipality affected thereby. Said decision shall be binding upon all parties, the state, the county, city and county, municipality, or district, and the company unless set aside by a court of competent jurisdiction, and each such assessor must note the decision of his assessment-roll, and must assess such property accordingly.

2. Notice by State Board of Equalization of Property Regarded Nonoperative. Hearing. If the state board of equalization shall find in the report of operative property furnished to said board by any company under the provisions of section three thousand six hundred sixty-five *c* of this code, any piece or parcel of property which said board regards as nonoperative property, or partially operative and partially nonoperative, the board shall, within thirty days after receiving such report, notify said company thereof in writing, which notice shall contain a general description of the property and the reasons for regarding the same as nonoperative. It shall also mail a copy of the notice to any assessor in whose county, city and county, municipality, or district the property is located. If an agreement between the said board, the assessor, and the company as to the proper classification of such property cannot be reached, then the said board shall, under such rules of notice as it may deem reasonable, set a date for a hearing, at which the assessor and the company may be present or represented. At such hearing the board shall, from the evidence presented and from the best information it can obtain, decide the matter in dispute, and determine whether such property is operative or nonoperative, or in what proportion operative and in what proportion nonoperative. The said board shall enter its decision in its minutes, and shall send a copy thereof to the county assessor and the company, and also to the proper officer of any municipality affected thereby. Said decision shall be binding upon all parties, the state, the county, city and county, municipality, or district, and the company, unless set aside by a court of competent ju-

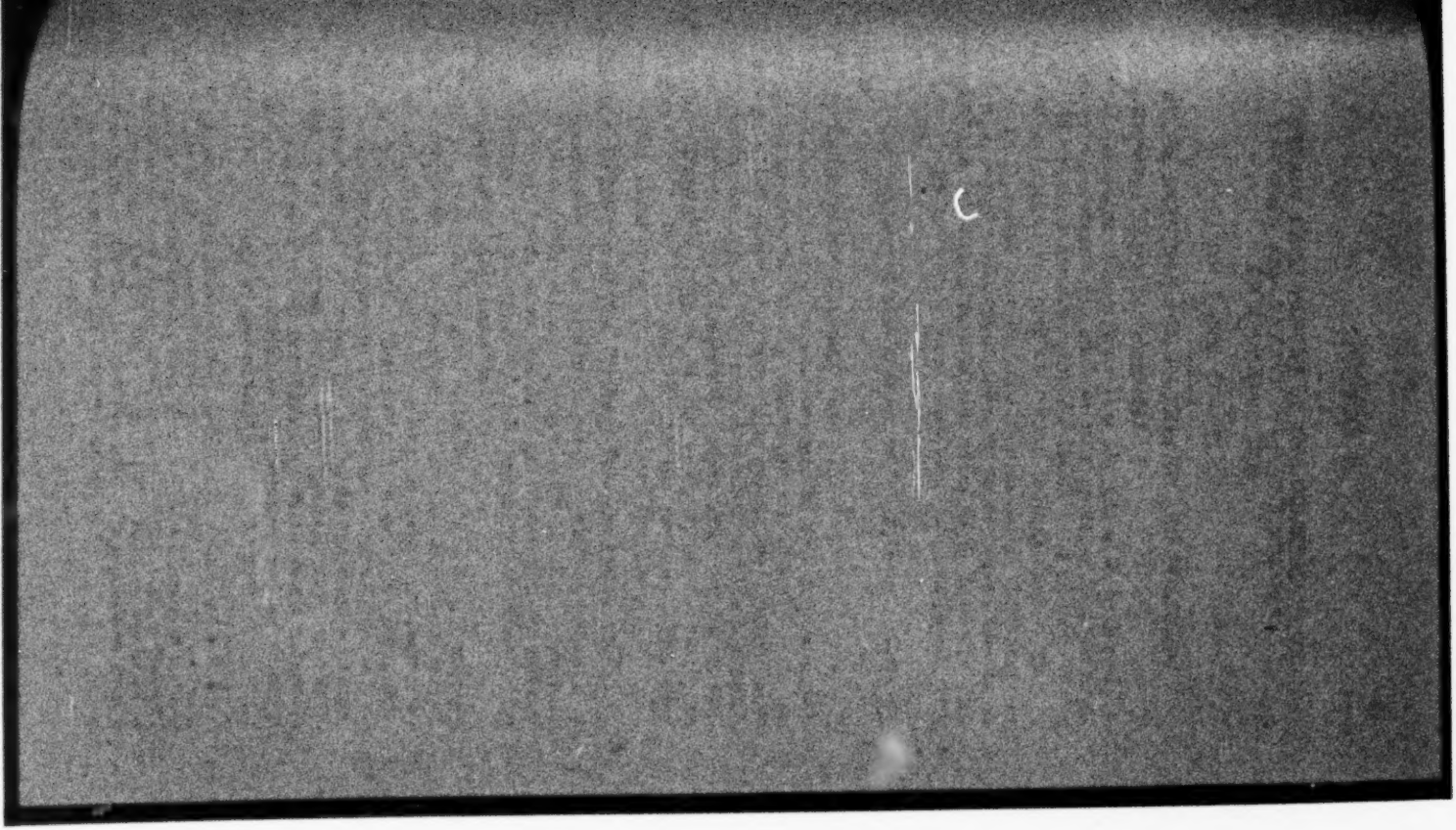
risdiction, and each such assessor must note the decision on his assessment-roll and must assess the property accordingly.

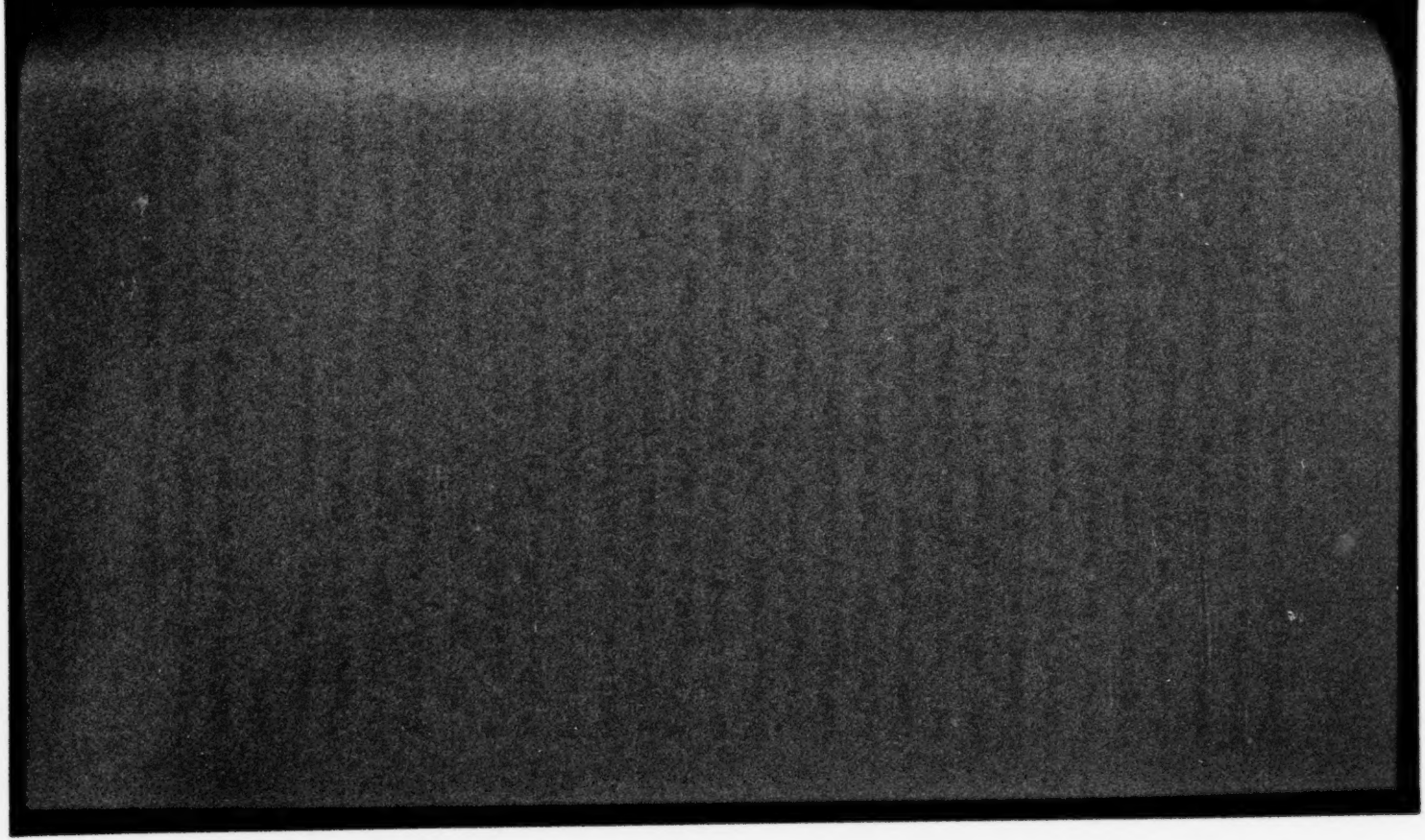
Sec. 3668a. Record of Assessments for State Taxes. Certificate. The state board of equalization must prepare each year a book, in one or more volumes, to be called the "record of assessments for state taxes", in which must be entered, either in writing or printing, or by both writing and printing, each assessment and levy made by said board upon the property and franchises mentioned in section three thousand six hundred sixty-four of this code, describing the property assessed, and such assessments shall be classified and entered, in such separate parts of said record as the board shall prescribe. On the first Monday in July the secretary of the state board of equalization must deliver to the controller of state the record of assessments for state taxes, certified to by the chairman and secretary of the board, which certificate shall be substantially as follows: "We, _____, chairman, and _____, secretary, of the state board of equalization of the state of California do hereby certify that between the first Monday in March and the first Monday in July, 19__, the state board of equalization made diligent inquiry and examination to ascertain all property and companies subject to assessment and taxation for state purposes, as required by the constitution of this state; that said board has faithfully complied with all the duties imposed upon it by the constitution and laws of the state of California; that said board has not imposed any unjust or double assessment through malice or ill will, or otherwise; nor allowed any company or property to escape a just assessment through favor or reward, or otherwise."

But the Failure to Subscribe Such Certificate to such record of assessments for state taxes, or any certificate, shall not in any manner affect the validity of any assessment.

Such Record of Assessments Shall Constitute the Warrant for the Controller to collect the taxes assessed and levied upon the property and franchises mentioned in section three thousand six hundred sixty-four of this code.

Sec. 3668c. Taxes Lien on Property and Franchises. The taxes levied under the provisions of section fourteen of article thirteen of the constitution of this state and sections of this code enacted to carry the same into effect shall constitute a lien upon all the property and franchises of every kind and nature belonging to the companies subject to taxation for state purposes, which lien shall attach on the first Monday in March of each year. Every tax herein provided for has the effect of a judgment against the company, and every lien created by the constitutional and statutory provisions aforesaid has the effect of an execution duly levied against all property of the delinquent; the judgment is not satisfied nor the lien removed until such taxes, penalties and costs are paid, or the property sold for the payment thereof. No final discharge in bankruptcy or decree of dissolution shall be made and entered by any court, nor shall the county clerk of any county or the secretary of state file any such discharge or decree, or file any other document by which the term of existence of any corporation shall be reduced or terminated until all taxes, penalties, and costs due on assessments made under the constitutional and statutory provisions aforesaid shall have been paid and discharged.





APPENDIX II.

EXTRACT FROM REPORT OF THE COMMISSION ON REVENUE AND TAXATION OF THE STATE OF CALIFORNIA — 1906.*

CHAPTER III.

GROSS EARNINGS TAX IN THEORY AND PRACTICE.

Gross Earnings Taxes Recommended.

The Commission recommends that the taxes to be levied on public-service corporations shall be in proportion to gross earnings. The reasons for this recommendation must be made clear, for a large part of the plan of reform depends upon them.

It is furthermore certain that, as this is an innovation in California, many persons will desire to satisfy themselves as to whether the rates recommended for taxes to be levied in proportion to gross earnings are just and fair compared with other taxes.

It is the purpose of this chapter to bring these matters together.

Theory Demands Net Earnings Tax.

Theoretically all taxes, by whatever method they may be levied, should be apportioned among the taxpayers of every class according to net income. Theoretical writers on taxation have never advanced beyond the idea embodied in Adam Smith's famous dictum: "The subjects of every State ought to contribute toward the support of the government, as nearly as possible, * * * in proportion to the revenues which they respectively enjoy under the protection of the State."

Practical Difficulties of Net Earnings Tax Are Insuperable.

But practically it has proven impossible, without resorting to methods too inquisitorial to be consonant with that freedom of the individual, which is so jealously guarded under our system of government, to ascertain the net income of individuals for the purpose of levying taxes thereon.

There are two possible good substitutes for the theoretically good but practically unworkable tax on net income. One is a tax on the property, the other a tax on gross earnings. We know by bitter experience that the tax on property fails, especially where large corporate interests are affected. A tax on the gross earnings, at rates for the different classes of corporations which recognize in a broad general way the differences in the proportion of net earnings therein, is the substitute recommended by this Commission, in certain cases in which it seems to be practicable and equitable.

* This report is an appendix to the Journals of the Senate and Assembly—37th Session of the Legislature of the State of California, 1907, Volume 2. The report is also found in a separate official publication issued by the state printing office (*Bankers Life Co. v. Richardson*, 192 Cal. 113, 218 Pac. 586; *Story v. Richardson*, 186 Cal. 162, 198 Pac. 1057; *Southern Pacific Co. v. Lewis District No. 1*, 172 Cal. 345, 156 Pac. 502). The reprint here given is a page for page reprint from the latter publication.

The Justice and Equality of a Gross Earnings Tax.

It is not claimed that the gross earnings tax will be absolutely just and equitable in its effect upon each corporation in each of the different classes. No tax system has ever been devised which is strictly just. *But it is claimed that in certain cases such a tax would result in a far closer approximation to justice and equality than any other tax which this State could select.* The burden of taxation imposed thereby will vary from year to year as the fund out of which the taxes must be paid varies. A careful examination of the effect of the taxes, at the rates proposed, upon the individual corporations shows that the differences are practically unimportant.

The very able Ontario Commission on Railway Taxation, which reported in 1905, says:

Finding, then that the gross earnings tax would cause no substantial inequality in the case of the roads operating in Ontario, and that, as regards equality, there is little to choose between taxing on the gross and on the net earnings basis, the choice between these might very well be determined on the ground of facility and certainty in ascertaining what is gross and what is net revenue. But there is very little difficulty and dispute in determining what is gross revenue, while there is endless difficulty and dispute in determining what is net revenue, especially where it is to the interests of the companies to minimize net revenue in order to escape taxation. Hence, there would seem to be no hesitation in selecting gross revenue as the simplest and most direct, and considering all the roads, the most equitable basis for taxation.

The essential fairness of taking earnings as a basis for the taxation of corporations is based on the general principle that the taxes vary with the capacity of the company to pay them, whereas taxation on the basis of general property results in all manner of inequality. The amount of tangible property required by the various corporations has, in the first place, no necessary relation to their relative earning power, and, in the second place, bears no accurate relation to the earning power of the same company at different periods. The capital stock tax has something of the same defect in addition to those already mentioned, yet it has a certain amount of flexibility. Only the tax on earnings follows automatically the capacity of the corporation to pay, and while even it has its inequalities, yet it is very much more equitable than any other practical system.

Practical Advantage of a Gross Earnings Tax.

Taxation is of necessity largely a matter of expediency, and practical considerations naturally outweigh theoretical ones. The advantages of a gross earnings tax on public-service corporations are largely practical. They are: (1) *Certainty and ease of administration.* Gross earnings can be concealed or misrepresented only by outright and easily detected fraud. Unlike property values or net earnings they are not affected by differences of opinion and depend on nobody's judgment or discretion. They are often a matter of published record. After the gross earnings are determined the rest is a matter of mere arithmetical computation. (2) They follow the capacity of the taxed subject to pay. (3) They enter every year in the same proportion into the accounts and can be computed in advance. (4) They are less likely

to be shifted from the taxpayer to some one else than any other tax. (5) In the words of the Ontario Commission above referred to:

One of the most important advantages of the gross earnings tax is that **it does away with the difficulty about the taxation of franchises.** Probably no aspect of modern economic wealth has given rise to such elaborated and confused discussion and even outlandish theorizing as the so-called "franchise" values. Without attempting to follow the lines of popular discussion on the subject, it may be sufficient here to indicate briefly that there are two distinct senses in which the term "franchise" is used to indicate a property or economic value. It is the confusion of these two economic phrases, with the occasional introduction of purely legal aspects of franchise, which has contributed so much to the darkening of counsel on the subject.

HOW TO DETERMINE THE RATES FOR GROSS EARNINGS TAXES ON THE DIFFERENT CLASSES OF CORPORATIONS.

Equal Taxation.

In all of those states in which, in recent years, a change has been made in the taxation of public-service corporations, either from the ad valorem system to a gross earnings tax, or from a gross earnings tax back to an ad valorem system, or in which any substantial change or reform has been suggested in regard to the taxation of public-service corporations, the question has always been raised whether the proposed rates or methods of taxation for such companies would result in "equal taxation". It is difficult to determine exactly what is meant, in this connection, by "equal taxation", but in the popular mind, as expressed during the discussions of such proposed reforms, there has been an idea that, by whatever method a railroad, for example, may be taxed, the burden of taxation thereon should be, and must be, as heavy as that which is borne by a farmer or by an owner of real estate and personal property on the regular assessment rolls. The idea seems to be that if the tax is levied upon the gross earnings, it must result in the imposition upon a railroad or other public-service corporation of a burden fairly equal to that which it would bear if fully assessed on an ad valorem basis as any other property might be.

In view of the strength of the popular feeling that taxes should be "equal", and of the obvious and essential justice of such a demand, it is highly important to discover a practical method for determining whether the burden of a tax which it is proposed to impose upon the gross earnings of a given class of corporations is the equivalent or not of a tax which might be levied under an ad valorem plan. Such a method has been devised by this Commission. By the application of this method we can ascertain what rate of tax on the gross earnings is the equivalent of a given tax rate on the property, and *vice versa*. This will make it possible to compare any proposed gross earnings tax with an assumed "fair" rate on property.

Briefly stated that method is: To determine what tax rate on gross earnings is the equivalent of a given rate on the property, for a given class of public-service corporations, (1) ascertain what percentage of the gross earnings is net, (2) ascertain what rate of interest would constitute a fair return to investors in the securities of the class of public-service corporations under consideration, then (3) divide the percentage of net earnings by the rate of interest and multiply the result by the given tax rate on the property.* *This method is not as rigid or as infallible as the mathematical statement of it might seem to imply. There is still room for difference of opinion.* But it has been found of great practical value in testing the probable effect of different rates on any set of assumptions.

Classification of Corporations.

The first step in the application of this method by the Commission was the determination of the class to which a corporation belongs by virtue of the percentage which its net earnings bears to its total gross earnings. An examination of the accounts of different classes of public-service corporations showed that they fall into very distinct classes according to the percentage which their net earnings bear to their gross earnings. This does not mean that every company belonging to a given class has the same percentage of net earnings to gross. But merely that *each of the great classes of public-service corporations presents a type* to which the individual companies tend to conform, and from which they differ only while young or while for some other reason incomplete or imperfect.

Thus, for example, we found that railroad companies, operating steam railroads, normally pay about 64% of their gross earnings for operating expenses, leaving 36% to pay interest upon bonded indebtedness, dividends upon capital, and similar items. That is, out of every $100 received, $64 goes to pay for wages, fuel, maintenance of way and equipment, and other items of cost involved in operation, and $36 is left for payment of interest on bonds, dividends on stock, and similar items. It is this $36 which gives value to the property. For fifteen years this average rate has not varied in the United States as a whole more than two points. City water companies, to take another example, ordinarily have a very much lower percentage of operating expenses, often as low as 25%, and consequently have as high as 75% net earnings, or funds available for the payment of interest and dividends. Other classes of corporations again, such as the telephone companies and express companies, have relatively high operating expenses and

* Expressed algebraically, let t equal the tax rate sought, n equal the percentage of net earnings to gross, i equal the interest rate on the investment, and r equal the given tax rate on property; then: $t = \frac{n}{i} \times r$.

only a small proportion of net revenues. As it is the amount of net revenue which determines the value of the property of these corporations as of any other property, so on the well-known principle of "capitalizing" the income at a predetermined or agreed rate of interest, it will readily be seen that a corporation with net returns large in proportion to its gross earnings has a larger property or capital value than one with a smaller percentage of net earnings. For example, as has been said, railroads earn about 36% net out of all receipts, and if this were capitalized at 6% would have $600 of capital for every $100 of gross earnings; another class of corporations earning, say, 24% net, would, if capitalized at 6%, have $400 worth of property for every $100 of gross income, while a city water company with 60% net, if capitalized at 6%, would have $1,000 worth of property for every $100 of gross income. If, however, 8% be taken as the rate of interest constituting a fair return to be allowed the stock and bond holders upon their investment, and as the basis for capitalization, these sums would change, and railroads with 36% net would have $450 of capital for every $100 of gross earnings; a company with 24% net would have $300 of capital for every $100 of gross earnings, and a water company with 60% net would have $750 for every $100 of gross earnings.

Computing the Tax Rate.

In order to compute what rate of taxation on gross earnings is the equivalent of a given rate of taxation on the property, we have simply to divide the percentage of net earnings by the assumed rate of capitalization and multiply the result by whatever tax rate on the property we wish to compare the gross earnings rate with. Thus, for example, if we wish to impose, in the form of a gross earnings tax, a burden which shall be the equivalent of a tax of 1½% on the property, then in the case of a railroad, taking the figures assessed above, we divide 36 by 6 or 8 whichever shall be determined upon as a fair rate at which to capitalize railroad earnings, and multiply the result by 1½, obtaining, at 6%, 9% as an equivalent rate on gross earnings, or at 8% as a basis of capitalization, 6¾%. If the tax rate on property or capital were fixed at 1%, the above rates would become 6% and 4½%.

Net Earnings Defined.

In applying the above method it is obvious that we must have a fixed and uniformly applied definition of what constitute net earnings. Since the object of ascertaining the net earnings is to ascertain from them the value of the property, it is obvious that the net earnings should include all things and only such things as belong to the owners of the property, whether they be the stockholders, or the bondholders, or the lessors of property used by the corporation. Hence the

operating expenses, which are deducted from the gross earnings in order to ascertain the net earnings in this sense, should include only the bare expenses of operation and of maintenance to the narrowest sense of those terms. The operating expenses would include, in the case of a railroad, only the items which are denominated and defined by the Interstate Commerce Commission as "maintenance of way and structures," including: "repairs of roadway and renewal of rails and ties," "repairs and renewal of bridges and other structures"; "maintenance of equipment," "conducting transportation," including: "salaries and wages in the operating department," "supplies," "car mileage," "switching charges," "damage for injuries," "advertising," "outside agencies and commissions"; and "general expenses." They would not include "taxes," "rental of tracks and terminals," "interest on bonds," nor "balances available for dividends. These terms, so far as they apply to railroads, have been carefully defined, for the United States at large, by the Interstate Commerce Commission, and for California by our own State Board of Equalization, and in general are fully understood and applied by all more careful accountants. Precisely analogous items are carried in the accounts of almost all public-service corporations, and the accounts can always be segregated under similar divisions.

Rents or Rental Charges Not Included Among Operating Expenses.

Some corporation officers have argued before the Commission that rent is an operating expense and should be deducted before the net earnings are computed. This rests on a fundamental misconception of the purpose of ascertaining net income. If net income is to be used to determine the rate of a tax on gross earnings, such tax to be *in lieu of all taxes* on PROPERTY USED IN OPERATION by a corporation, all net income accruing to that property or from its use must be included. All persons readily admit that interest on bonded indebtedness is not an operating expense; if that is the case, rent is not an operating expense. It would have made no difference, so far as this matter is concerned, whether the Southern Pacific build the Lucin cut-off, as it did, with the proceeds of bonds on which it pays a certain sum annually as interest, or had leased that great bridge from some other company, paying the same sum annually as rent. In neither case would the annual payment be an operating expense; in each case it is a return to property.

Annual Payments on Account of the Franchise.

In the same way, and even more fallaciously, corporation officers, especially street railroad officers, have argued that they should be allowed to deduct from the amount of taxes due the State any payments made to the cities on behalf of the franchises. This argument is even more shallow than the preceding one; it is, in fact, little short of absurd.

It rests upon the mere accidents that these payments are sometimes miscalled taxes and are usually measured by the gross earnings. As a matter of fact, these payments are rentals, for the use of a certain kind of public property, namely, the streets. It is quite as absurd for a street car company to call these "taxes" and ask that they be allowed to subtract such payments from their taxes due the State, as it would be to call the rents paid for office buildings taxes and ask to have them deducted.

A street car or other public-service corporation can acquire its franchises from cities in one of two ways: (1) it may buy them outright for a certain sum down, in which case it usually issues bonds for the amount and pays the bondholders interest thereon. No one would have the effrontery to argue that such interest was an operating expense. Or, (2) it may make a series of annual payments in proportion to business done or gross earnings. These payments are precisely the same in nature as the interest payments under the first method, and so closely are such things figured when franchises are bid for that the one is the precise equivalent of the other.

These payments are rents and should not even be included in operating expenses; to ask that they be considered taxes and deducted from the amount paid the State is to ask exemption for one of the most valuable items of property the companies use, namely, their franchises.

Reports Made to the Commission.

In the reports asked for by this Commission from the different public-service corporations, the effort has been made to ascertain:

First, the gross earnings from operation; under which would not be included any returns or revenues obtained from investments in property not directly used in the peculiar business in which the corporation was engaged. Thus, for example, revenues obtained from the sale of railroad lands or from investments of surplus or sinking funds held by other classes of corporations would not be included in the gross earnings.

Second, the operating expenses in the sense above defined, exclusive of all items belonging to the capital account, and of the nature of interest, rents, etc.

Earnings of Similar Companies Outside of California.

In order to ascertain whether the reports made to us by the California companies were normal or whether they represented exceptional and unusual conditions, also for the purpose of obtaining a check upon the accuracy of the returns made to us, the Commission has ascertained, so far as possible, from other sources what the proportion

of operating expenses to gross earnings was for each of these different classes of corporations in other parts of the country. In this way it is thought that the classes into which the different corporations fall, according to the percentage which their net earnings bear to the gross earnings, have been representatively determined, and the various types of corporations ascertained. The detailed figures for each of these will be given in connection with the special discussion of the taxation of each class of corporations.

Rate of Capitalization.

The rate of interest which should be allowed in equity to investors in each of the different classes of corporations is a matter which is often discussed in connection with fixing the rates or charges for their services to be allowed public service corporations by county and city boards and the like. The Commission has made no effort to solve the much vexed question of what the rate *ought* to be, but only what rate is accepted. It has simply undertaken to ascertain, as nearly as may be, in the case of each of the various classes of corporations, approximately what rate the market quotations seem to indicate as one satisfactory to the investors themselves. Thus, for example, it was ascertained that the investors in the securities of the Southern Pacific Company in 1904 were contented with 5.655% returns on their investment, which allowing 1% additional for taxes, would give us 6.655% as the basis of capitalization. The Santa Fé investors were content with 6.172%, and so on. The percentages to be used will vary somewhat with the risk of the business and are ordinarily higher for small companies. This offsets to some extent the fact that their net receipts are a smaller proportion of their gross income than in the case of larger companies, owing to the greater expense of operation.

The rates at which the net income of different classes of industries should be capitalized is fairly well known among business men, and the rates adopted by the Commission for the different classes of corporations are those which have generally prevailed.

The Rate on Property.

What constitutes a fair rate on the property with which to compare the effect of any given rate on gross earnings is an extremely intricate question. The prevailing rates of taxation as ascertained by the Commission throughout this State are: About $1.75 per $100 of assessed valuation for property outside of corporate limits, and about $2.55 per $100 of assessed valuation for property inside corporate limits. The average of all taxes both inside and out is about $1.825 per $100 of assessed valuation. The Commission has been inclined to think that the assessed valuation is about 60% of the true value. This percentage

varies in different parts of the State very largely, and varies considerably from year to year. It varies also from one piece of property to another. There is no practical method of ascertaining exactly what this average percentage is short of an attempt to revalue all the property of the State, which is equivalent to remaking the assessment rolls of each and every county. This is a task far beyond the means of the Commission and the time at its disposal. It is practically certain from the extensive investigation made by the Census Bureau and stated in another chapter of this Report, that farming lands are assessed on the average at about 65%, making taxes on this class of property on the average of 1.14% of the true value. The tax rate on city property, being considerably higher, would offset to a considerable extent any lower valuation that may prevail in the cities. Even if property is assessed as low as 50% of its true value the average burden of taxation throughout the State is still close to 1%.

The Commission has been literally bombarded with so-called "evidence" submitted by interested parties that property is assessed for less than 60% of its true value. This "evidence" usually takes the form of *ex parte* statements as to assessed and market values, and sometimes of actual tax bills and deeds showing the sale of the property covered thereby at prices far above the assessed value. The ultimate effect of this "evidence" on the minds of the members is that these are more or less cleverly selected special cases, usually isolated; exceptions which rather prove than disprove the rule. Assessor after assessor has declared that he never knowingly assesses any property at less than two-thirds of its "full cash value" as defined by law, which, it must be remembered, is not the same as "highest market value." To offset the above evidence of undervaluation it would be easy to collect just as many instances of overvaluation. It is the average that counts, and *the average is fixed by the multitude of common people who pay taxes on their little homes or farms*, not by the shrewd speculators who evade taxes on property whose values they boom.

The Commission has assumed throughout this Report that property now on the tax rolls bears a burden of about 1% of its true value. It should be stated in this connection that the Commission uses the term "true value" or "full cash value" in the sense in which it is defined in the Code, namely, that value at which the property would be taken in payment of a just debt due from a solvent creditor. This is not the equivalent of the highest market value which the property might command under special circumstances. It should further be stated that the Commission means in this respect to include only property now on the tax rolls, and that in the nature of things no allowance is made or can be made for additional property such as personal property belonging to the owner of this class of property but concealed from the assessor

so as to evade taxation. This Commission holds that this is the only proper basis for comparison as to the actual tax rates, and regards the criticisms sometimes advanced to the effect that this rate makes no allowance for property which ought to be assessed and is not assessed, as not well taken. The fact is, that the property which we succeed in reaching under our present tax system bears on the average a burden of taxation equal to about 1% on its full cash value.

What constitutes a "fair rate" of taxation must be determined primarily by the needs of the different branches of the government. The amount which it is necessary to raise apportioned among the subjects upon which the levy is to be made will ultimately give the exact rate. But when we depart from the method of apportionment heretofore in vogue and establish a fixed tariff upon certain classes of tax subjects, as is proposed by this Commission, for the subjects selected for State taxation, we have to assume in advance what will ultimately be the rate necessary to be levied upon other property. The Commission is of the opinion that in the long run the various classes of property in the State will be called upon to contribute at the rate of about 1% per annum to the support of the different branches of government, and that this amount is about what the services of the government are worth to the taxpayers, and sets approximately what the various branches of the government ought to levy.

In another sense, what constitutes a fair rate of taxation will ultimately be determined by the general consensus of opinion. The "fairness" of a tax rate depends primarily upon the value of the government's services to the taxpayer. This, like any other "value" not fixed by a price in the open market, is largely a matter of opinion. In the United States in general where most of the taxes are levied on property the rates run from about 1% to 1½% or in extreme cases to 2% upon the true value of the property. Business men, especially those who deal in real estate, very generally reckon that 1% is the burden of taxation, and pretty generally agree that such a rate is fair and equitable. If the tax rate exceeds this by very much, there is usually a complaint and the government is regarded as extravagant or criticised for waste of public money.

The adoption of 1% as the basis of all computations and not the actual averages ascertained, namely, 1.14% for rural property and 1.53% for city property, is justified on the ground that the plan of separation proposed will reduce the present burden of taxation on real estate by about the amount of the fraction rejected.

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CHARLES ELMORE

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1927

No. 133

ED. W. HOPKINS, Assessor of the County of Los Angeles, State of California, F. M. ROSS, Deputy Assessor of the County of Los Angeles, State of California; W. O. WELCH, Tax Collector of the County of Los Angeles, State of California; H. A. PAYNE, Auditor of the County of Los Angeles, State of California, and COUNTY OF LOS ANGELES, a body corporate and politic, *Petitioners.*

vs.

SOUTHERN CALIFORNIA TELEPHONE COMPANY (a corporation), and THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY (a corporation), *Respondents.*

RESPONDENTS' ANSWER TO PETITION FOR A REHEARING OR MODIFICATION OF DECREE.

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PARTRIDGE-WALKER PRINTING CO., SAN FRANCISCO

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Union Tank Line Co. v. Richardson, 183 Cal. 409, 191 Pac. 697	2

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Respondents.

RESPONDENTS' ANSWER TO PETITION FOR A REHEARING OR MODIFICATION OF DECREE.

In their petition for a rehearing or modification of decree petitioners advance two points. Neither of them

is new. Both were fully discussed in the briefs heretofore filed and no new argument or authority is advanced.

The first point, concerning the relation between rate fixing and taxes upon public service corporations, is discussed on pages 110 to 120 of petitioners' brief and is answered on page 63 of the respondents' brief. The argument on this subject, as framed in the petition for rehearing, is, in effect, that since taxes are taken into account by rate fixing bodies, public service corporations cannot complain of unequal or discriminatory taxation, because adjustment for any inequality or discrimination in that behalf is made in the fixing of rates. Manifestly, however, it is not the concern and function of rate making bodies to fix taxes in a just and equal manner. If petitioners' argument were sound it would mean that no public service corporation, the service rates of which are subject to regulation, could ever successfully resist the collection of any tax, no matter how unjust, discriminatory or devoid of lawful foundation.

Petitioners' second point, that the decision of this court is contrary to decisions of the State Supreme Court preceding the opinion in the mandamus case (*Pacific Telephone and Telegraph Co. v. State Board of Equalization*, 74 Cal. Dec. 96), which was set aside upon rehearing (Resp. Br. p. 21), has likewise been fully discussed in the briefs heretofore filed (*Pacific Gas & Electric Co. v. Roberts*, 168 Cal. 420, 143 Pac. 700 (Pet. Br. pp. 109, 170, 171, Resp. Br. pp. 51, 63-64; see also pp. 16, 17, 34, 35, 46); *Union Tank Line Co. v. Richardson*, 183 Cal. 469, 191 Pac. 697 (Pet. Br. p. 174, Resp. Br. p. 64); *Pacific Gas & Electric Co. v. Roberts*, 176 Cal. 183, 167 Pac. 845 (Pet. Br. pp. 172, 173, Resp. Br. p. 64)).

There is no significance, so far as the case at bar is concerned, in the proposed constitutional amendment which was defeated in 1922 (Pet. for Rehearing, p. 12). The purpose of that constitutional amendment was to change the rule declared by the State Supreme Court in *Pacific Gas & Electric Co. v. Roberts*, 176 Cal. 183, 167 Pac. 845 (Resp. Br. p. 64), so as to permit the deduction from gross receipts upon which state taxes are paid, of any amount paid by a public utility in purchasing the commodity in which it dealt, that is, to permit electric companies to deduct the amounts paid for electricity or gas companies to deduct the amounts paid for gas, etc. We have already pointed out (Resp. Br. p. 64) that the decision in the *Roberts* case does not uphold unequal or discriminatory taxation, but, on the contrary, was strictly in accord with the principles of the gross receipts tax and with the theory on which the rates of that tax were fixed (Resp. Br. p. 64). By rejecting the proposed constitutional amendment the people declined to make an illogical exception to this theory.

The matter of franchise values to which petitioners refer (Pet. for Rehearing p. 8) is discussed in the briefs on file (Resp. Br. pp. 36, 64; Pet. Br. pp. 151-152).

We respectfully submit that the petition for rehearing should be denied.

Dated, San Francisco,
February 8, 1928.

ALFRED SUTRO,
Attorney for Respondents.

OSCAR LAWLER,
EUGENE M. PRINCE,
Of Counsel.